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Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

America Can No Longer Ignore The Federal Deficit

The recriminations and hand-wringing going on in Washington these past few weeks must amaze any person who has to live within a budget. Members of Congress and the Administration are finding out what most Americans have known for a long time: Piling up debt is a dangerous practice. At some point, the payment comes due.

The problem of the deficit had been debated and, more or less, dismissed during most of the 1980s. But when the stock market plunged on October 19, much of the blame was placed on the Federal government's inability to rein in its deficit spending. In a knee-jerk reaction to such accusations, Congress and the Administration held a domestic summit in an effort to reach some decisions on reducing Washington's budget deficit.

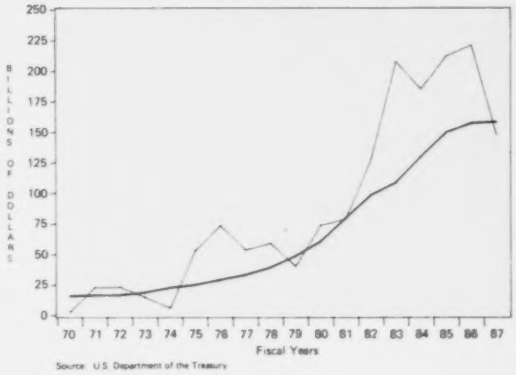
After four weeks of debate and compromise, the summiteers avoided making any drastic decisions. Instead, the politicians emerged from deliberations with a proposal that would cut the deficit by $30 billion in fiscal year 1988 and $46 billion more in the next fiscal year. Rather than tackling any major issues, such as entitlement programs, the accord was, perhaps, the bare minimum that could have been presented without further disrupting the financial markets. Indeed, the reception on Wall Street was lukewarm at best. The stock market rose only slightly on the summit news, while the bond markets remained lackluster.

During their meetings, Congressional leaders and the Administration had only two means with which to battle their deficit addiction. One was to raise taxes. Raising taxes, however, is a curse on a politician's re-election campaign. So, although the budget accord agreed to increase taxes by $9 billion in FY 1988, the summit members were reluctant to name specific sources for these added revenues, since no group is likely to volunteer to shoulder the extra tax burden. Moreover, any increase in income or excise taxes has been ruled out by the Administration, so Congress will be hard-pressed to identify definite tax increases.

The Need To Reduce Spending

The other option was to reduce spending. Under the summit proposal, $11.6 billion will be cut away from the Federal budget this year. Defense spending would be pared by $5.3 billion—an important achievement for the summit since the Administration had previously refused to reduce the Pentagon's budget. Other cuts would come from Medicare, farm price supports and student loan programs.

TOTAL INTEREST PAID BY THE FEDERAL GOVERNMENT (THICK) VS. FEDERAL BUDGET DEFICIT (THIN)



Source: U.S. Department of the Treasury

Some critics, however, have noted that Washington would have been better off doing nothing. That would have allowed the automatic spending cuts of the Gramm-Rudman Act to kick in. And while these cuts would represent "real" reductions in spending, they nevertheless are less politically discriminating than those in the budget compromise: Defense spending would have dropped by 10.5 percent and other programs, by 8.5 percent.

One growing problem is that Congress is running out of room in which to cut spending. Politicians are wary of tampering with entitlement programs such as Social Security, even though the Federal government spends about as much on Social Security and Medicare as it does on defense. Even more important: The heavy debt accumulation of the recent past has created a huge interest payment for the Federal government. As the chart shows, interest expense has risen in

Manufacturers Hanover Economics Department 17/270

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tandem with the budget deficit. Indeed, in FY 1987 total interest paid outpaced the Federal deficit by $10 billion. As long as the red-ink accumulates in Washington, the interest bill will garner a larger share of Federal outlays. Already in the first half of 1987, net interest paid totaled over $70 billion, an amount equal to what the government spent on agriculture, energy, the environment, housing, transportation, health and veterans benefits combined!

Of course, Congress has another alternative when dealing with the budget. That is to continue its profligate ways: Spend more than is taken in and borrow the difference. However, America is quickly finding out the errors of this approach. Much has already been made of the growing reliance of the Federal government on foreigners to finance the budget deficit. Equally significant is the "crowding out" of other debtors by the public sector in the financial markets. In the late 1970s, total government deficits accounted for only ten percent of net private domestic savings; by 1986, the federal deficit alone used up 90 percent of net private savings. This had led to higher interest rates than would otherwise ensue, and the inability of some worthy private

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/18/87)	172,635	+ 30	+ 18,537
New York City (11/25/87)	38,016	– 345	+ 3,889
Commercial Paper (11/25/87)	359,870	+ 3,228	+ 33,399

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/18/87)	276,472	+ 189	+10,251
New York City (11/25/87)	56,963	– 878	– 4,459

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (11/18/87)	806,516	– 2,777	+43,325
New York City (11/25/87)	171,973	– 1,364	– 834

Financial Markets

	Friday 12/4/87	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	5.54%	– .23	– .02
180-Day Bills†	6.43	– .07	+ .79
Longest Bills†	6.95	– .16	+ 1.18
Recent Issues:			
7 3/4s 11/30/89	7.65	– .20	
9 1/8s 9/30/91	8.17	– .22	
8 7/8s 11/15/97	8.90	– .20	
8 7/8s 8/15/17	9.07	– .11	
Municipals:			
Bond Buyer–20 Bond Index* (12/3/87)	7.90%	– .06	+ 1.13
Blue List Total ($ Million)	$1,151	+ $ 30	–$1,212
30-Day Visible Supply ($ Million)	$1,867	+ $ 127	–$2,120
Total	$3,018	+ $ 157	–$3,332
Corporates:			
Moody's Aa Composite (12/3/87)	10.29%	+ .04	+ 1.27
30-Day Visible Supply ($ Million)	$5,788	+ $3,925	+$1,923
Stocks:			
Dow-Jones Averages:			
Industrials	1,766.74	– 143.74	– 158.04
Transportation	661.00	– 67.43	– 199.87
Utilities	173.13	– 7.05	– 38.81
65 Stocks	653.73	– 52.35	– 106.55
N.Y.S.E. Composite Index	125.91	– 9.25	– 17.78
N.Y.S.E. Avg. Daily Vol. for Week (000's)	191,543	+ 49,335	+ 18,982

*34% Taxable equivalent 11.97%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 12/4/87	Week Ago
Overnight	6.69%	6.50%
1 month	7.94	7.88
3 month	7.69	7.63
6 month	7.69	7.63
1 year	7.94	7.94
EURODOLLAR BONDS Average Yield		
Medium Term (5 yrs.)	8.95%	8.81%
Long Term (10 yrs.)	9.87	9.66

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/4/87)	Currency Per U.S. $	Week Ago
Canada	1.3141	1.3096
France	5.6250	5.6365
Germany	1.6545	1.6570
Italy	1220.50	1223.50
Japan	132.10	133.77
Mexico	1769.20	1731.80
Switzerland	1.3525	1.3600
U.K.*	1.8135	1.8075

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (12/4/87) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.9%	–4.3%

projects to obtain funds from our credit markets.

There Is No Free Lunch

When the final budget plan reaches Congress, each party will be sure to hold the other responsible for the deficit problem. However, the blame extends beyond the halls and chambers of the Capitol. Americans have let the Federal government become everything to all people: the subsidizer of farmers, the payer of medical bills, the lender of last resort. This omnipotence has not come without a price, but, for too long, Americans have ignored the question of who will pick up the tab. And now this country has come face to face with a stark and dismal reality: There is no free lunch.

Unfortunately, eating *gratis* has become a national pasttime. It should be remembered that Washington's red-ink only mirrors the wishes of the electorate who demand more from their government than they are willing to pay for in the form of taxes. The dangers of living beyond our means are becoming more apparent. The shakiness of the global stock markets is just one signal that lunch is almost over. The time has come to decide how we are going to pay the check. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/2/87	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	226.743	+ 4.088	+23.045
Loans to Depository Inst.	.684	+ .003	+ .103
Float	.686	− .011	− .604
Total Reserve Bank Credit	243.410	+ 4.307	+21.972
Treasury Deposits with Federal Reserve Banks	3.403	+ .078	+ .797
Currency in Circulation	225.013	+ 1.351	+17.875
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	193.393	+ 1.775	+27.497
	12/2/87		
Member Bank Reserves:			
Total Reserves Held	57.962	− .159	+ 3.310
Excess (Deficiency)	1.223	+ .727	+ .093
Net Free Reserves	1.005	+ .736	+ .117
Monetary Aggregates †		**% Change Since 3 Months Ago***	**% Change Since Year Ago**
M1 (11/23/87)	759.5	+ 4.4‡	+ 7.0‡
M2 (October '87)	2,893.9	+ 6.4	+ 4.8
M3 (October '87)	3,650.8	+ 7.3	+ 6.0
Domestic Nonfinancial Debt (2nd Q'87)	7,954.0	+ 8.4	+ 11.0

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Four-week moving average.

New York Money Market

Offering Rates 12/4/87	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	5.34%	6.13%	6.52%
* Federal Agencies	7.00	7.10	7.12
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.58	8.18	8.64
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.50	7.50	7.80

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	6.70%	Jan.	7.71%
15- 29 days	6.70	Feb.	7.55
30- 59 days	7.50	Mar.	7.46
60- 89 days	7.38	Apr.	7.45
90-179 days	7.25	May	7.48
180-239 days	7.25	Jun.	7.47
240-270 days	7.25		

‡Industrial Paper—Prime			
30- 89 days	7.40%	†Federal Funds	
90-120 days	7.35	Effective Rate	6.85%

‡Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

		Latest Period or End of Period	Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'87	$ 4,521 r	$ 4,445	$ 4,266
Gross National Product (1982 Dollars)*	3rd Q'87	$ 3,833 r	$ 3,795	$ 3,718
Percent Change, Annual Rate	3rd Q'87	4.1 r	2.5	1.4
Change in Consumer Prices*	Oct '87	4.8% (1)	2.4% (1)	2.4%
Change in Producer Prices*	Oct '87	− 2.4%	3.6%	3.6%
Civilian Employment (Thousands of Persons) †	Nov '87n	113,500	113,187	110,432
Unemployment as % of Civilian Labor Force†	Nov '87n	5.9%	6.0%	6.9%
Personal Income*	Oct '87n	$ 3,841	$ 3,777	$ 3,578
Leading Indicators Composite Index (1967=100)†	Oct '87n	192.4	192.7	181.2
Industrial Production Index (1977=100) †	Oct '87	131.7	130.9	125.3
Net Change in Consumer Installment Credit †	Sep '87	$ 6.06	$ 5.01	$ 7.61
U.S. Merchandise Trade Balance	Sep '87	−$ 14.08	−$ 15.68	−$ 12.56
Plant and Equipment Expenditures*	4th Q'87	$406.37(a)	$398.04(a)	$388.69
Private Housing Starts (Thousands of Units)*	Oct '87	1,513	1,648	1,657
New Construction Expenditures*	Oct '87n	$ 407.9	$ 409.8r	$ 394.9
Total Business Inventories †	Sep '87	$ 682.4	$ 678.4	$ 653.7
Total Business Sales †	Sep '87	$ 462.1	$ 457.7	$ 437.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.
(1) Indicates new series.

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